

YES Prep Public Schools, Inc.

Consolidated Financial Statements
and Single Audit Reports
for the year ended June 30, 2016

YES Prep Public Schools, Inc.

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Independent Auditors' Report

To the Board of Directors of
YES Prep Public Schools, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of YES Prep Public Schools, Inc. (YES Prep), which comprise the consolidated statement of financial position as of June 30, 2016 and the related consolidated statements of activities and of cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of YES Prep as of June 30, 2016 and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

As part of our audit of the 2016 financial statements, we also audited the adjustments described in Note 2 that were applied to restate the 2015 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2015 financial statements of YES Prep other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2015 financial statements as a whole.

Supplementary Information

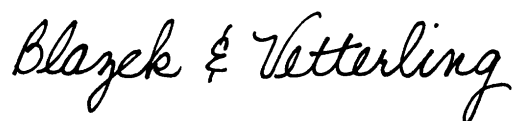
Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information on pages 14 through 22 is presented for purposes of additional analysis as required by the Texas Education Agency and is not a required part of the financial statements. The accompanying supplementary information included in the schedule of expenditures of federal awards for the year ended June 30, 2016 as required by Title 2 U. S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise YES Prep's basic financial statements. The budget variance explanations on page 22 are presented for purposes of additional analysis as required by the Texas Education Agency and are not a required part of the basic financial statements. The budget variance explanations have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 10, 2016 on our consideration of YES Prep's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering YES Prep's internal control over financial reporting and compliance.



November 10, 2016

YES Prep Public Schools, Inc.

Consolidated Statement of Financial Position as of June 30, 2016

ASSETS

Current assets:

Cash and cash equivalents (<i>Note 3</i>)	\$ 28,911,722
Receivables:	
Government agencies	15,030,313
Bequests	1,000,000
Pledges (<i>Note 4</i>)	884,000
Other	1,934,583
Prepaid expenses and other assets	<u>2,005,233</u>
Total current assets	49,765,851

Pledges receivable, net (<i>Note 4</i>)	949,000
Beneficial interest in charitable trust	2,236,762
Note receivable (<i>Note 5</i>)	10,422,800
Capitalized bond issuance costs	1,684,054
Bond proceeds held in trust (<i>Note 7</i>)	153,821
Bond sinking funds (<i>Note 7</i>)	11,369,121
Property and equipment, net (<i>Note 6</i>)	<u>100,542,311</u>
TOTAL ASSETS	<u>\$ 177,123,720</u>

LIABILITIES AND NET ASSETS

Current liabilities:

Accounts payable and other accrued expenses	\$ 3,106,706
Accrued payroll expenses	7,338,133
Construction payable	1,108,133
Accrued interest	749,193
Deferred revenue	3,123
Current portion of bonds and notes payable (<i>Note 7</i>)	<u>2,190,756</u>
Total current liabilities	14,496,044

Bonds and notes payable (<i>Note 7</i>)	<u>80,940,609</u>
Total liabilities	<u>95,436,653</u>

Minority interest in YES Prep Holdings, Inc.	12,815
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Commitments (*Note 10*)

Net assets:

Unrestricted	64,336,599
Temporarily restricted (<i>Note 8</i>)	<u>17,337,653</u>
Total net assets	<u>81,674,252</u>

TOTAL LIABILITIES AND NET ASSETS	<u>\$ 177,123,720</u>
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See accompanying notes to consolidated financial statements.

YES Prep Public Schools, Inc.

Consolidated Statement of Activities for the year ended June 30, 2016

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
OPERATING REVENUE:			
Government grants (<i>Note 9</i>)		\$ 93,500,558	\$ 93,500,558
Contributions	\$ 2,273,243	2,825,432	5,098,675
Program service fees	10,157,213		10,157,213
Special events	1,179,659		1,179,659
Cost of direct donor benefits	(140,691)		(140,691)
Interest (<i>Note 7</i>)	545,039		545,039
Other	33,781		33,781
Total operating revenue	14,048,244	96,325,990	110,374,234
Net assets released from restrictions:			
Program expenditures	91,496,113	(91,496,113)	
Capital expenditures	3,206,185	(3,206,185)	
Expiration of time restrictions	100,000	(100,000)	
Total	108,850,542	1,523,692	110,374,234
OPERATING EXPENSES:			
Program expenses:			
Instructional program	80,140,274		80,140,274
Auxiliary services	13,200,339		13,200,339
Total program expenses	93,340,613		93,340,613
General and administrative	9,979,213		9,979,213
Fundraising	1,510,420		1,510,420
Total operating expenses	104,830,246		104,830,246
CHANGES IN NET ASSETS	4,020,296	1,523,692	5,543,988
Net assets, beginning of year (<i>Note 2</i>)	60,316,303	15,813,961	76,130,264
Net assets, end of year	\$ 64,336,599	\$ 17,337,653	\$ 81,674,252

See accompanying notes to consolidated financial statements.

YES Prep Public Schools, Inc.

Consolidated Statement of Cash Flows for the year ended June 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES:

Changes in net assets	\$ 5,543,988
Adjustments to reconcile changes in net assets to net cash provided by operating activities:	
Contributions restricted for expansion of facilities	(2,000,000)
Loss on valuation of pledges	755,000
Depreciation	4,618,730
Amortization of bond issuance costs	122,395
Forgiveness of debt	(200,000)
Changes in operating assets and liabilities:	
Receivables	(850,013)
Prepaid expenses and other assets	(1,628,328)
Beneficial interest in charitable trust	(82,587)
Accounts payable and accrued expenses	1,634,251
Accrued interest	82,914
Deferred revenue	<u>(125,439)</u>
Net cash provided by operating activities	<u>7,870,911</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchases of property and equipment	<u>(919,162)</u>
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CASH FLOWS FROM FINANCING ACTIVITIES:

Change in bond sinking funds	(2,919,506)
Capitalized bond issuance costs	(156,281)
Proceeds from bonds and notes payable	7,500,000
Principal repayments of bonds and notes payable	(4,971,389)
Proceeds from contributions restricted for expansion of facilities	<u>3,161,667</u>
Net cash provided by financing activities	<u>2,614,491</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS	9,566,240
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Cash and cash equivalents, beginning of year	<u>19,345,482</u>
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Cash and cash equivalents, end of year	<u>\$ 28,911,722</u>
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Supplemental disclosure of cash flow information:

Interest payments	\$1,249,119
Property and equipment acquired with bond proceeds	\$11,370,208

See accompanying notes to consolidated financial statements.

YES Prep Public Schools, Inc.

Notes to Consolidated Financial Statements for the year ended June 30, 2016

NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – YES Prep Public Schools, Inc. (YES Prep) operates twelve Texas Open-Enrollment Charter Schools under one state charter. The schools are located in Houston, Texas and serve approximately 10,000 students from 6th through 12th grade. Additionally, YES Prep operates two schools within Spring Branch Independent School District and one school within Aldine Independent School District on a contract basis. These partnerships (Partnerships) are conducted outside of YES Prep's charter.

YES Prep Facilities, LLC (Facilities) was created in 2013 to operate buildings on YES Prep's Fifth Ward and Northside campuses and to construct improvements on those buildings. Facilities leases the buildings to YES Prep. Facilities holds New Market Tax Credit debt incurred to improve the buildings. YES Prep owns 99% of Facilities. The remaining 1% interest is owned by YES Prep Holdings, Inc., a Texas non-profit corporation that is not under the control of YES Prep. The 1% interest owned by YES Prep Holdings, Inc. is reported as a minority interest on the consolidated statement of financial position of YES Prep.

Basis of consolidation – These financial statements include the assets, liabilities, net assets and activities of YES Prep Public Schools, Inc. and Facilities (collectively YES Prep). All balances and transactions between the consolidated entities have been eliminated.

Federal income tax status – YES Prep is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(1) and §170(b)(1)(A)(ii).

Cash equivalents include highly liquid investments with original maturities of three months or less.

Pledges receivable that are expected to be collected within one year are reported at net realizable value. Amounts that are expected to be collected in future years are discounted to estimate the present value of future cash flows. An allowance for uncollectible pledges receivable is provided when it is believed pledges may not be collected in full. The adequacy of the allowance at the end of each period is determined using a combination of historical loss experience and donor-by-donor analysis of pledges receivable balances each period.

Beneficial interest in charitable trust – YES Prep is the beneficiary of an irrevocable charitable trust that is reported at the fair value of the underlying assets. The purpose of the gift is to provide college scholarships to YES Prep graduates who attend out-of-state colleges. The inputs used to measure fair value are considered to fall within Level 3 of the fair value hierarchy.

Capitalized bond issuance costs represent costs incurred related to the issuance of bonds and notes payable and are amortized as interest expense over the term of the bonds or notes.

Property and equipment is reported at cost if purchased or at fair value at the date of gift if donated. YES Prep recognizes depreciation using the straight-line method over the estimated useful lives of the assets, which range from 5 to 40 years for buildings and improvements and 2 to 12 years for furniture, equipment and vehicles. YES Prep capitalizes additions and improvements that have a cost of more than \$5,000.

Net asset classification – Contributions, interest income and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations even though their use may be limited in other respects such as by contract or board designation.
- *Temporarily restricted net assets* include contributions and interest income restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.

Grants and contributions are recognized at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are classified as restricted support. Conditional contributions are included in contribution revenue when the conditions are substantially met. Program service fees are recognized in the period in which services are provided.

Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted revenue. Absent explicit donor stipulations about how long those long-lived assets must be maintained, YES Prep reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Donated materials, use of facilities and services – Donated materials and use of facilities are recognized at fair value when an unconditional commitment is received from the donor. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts of reported revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Recent accounting pronouncements – In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This amendment requires that debt issuance costs related to a recognized debt liability be presented in the statement of financial position as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The ASU is effective for fiscal periods beginning after December 15, 2015 and is to be applied retrospectively. YES Prep will adopt this ASU effective for the fiscal year ending June 30, 2017.

In August 2016, FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU are the first phase of changes aimed at providing more useful information to users of not-for-profit financial statements. Under this ASU, net assets will be presented in two classes: *net assets with donor restrictions* and *net assets without donor restrictions* and underwater endowments will be grouped with *net assets with donor restrictions*. New or enhanced disclosures will be required about the nature and composition of net assets, and the liquidity and availability of resources for general operating expenditures within one year of the balance sheet date. Expenses will be required to be presented by both nature and function and

investment return will be presented net of external and direct internal investment expenses. Absent explicit donor stipulations, restrictions on long-lived assets will expire when assets are placed in service. The ASU is effective for fiscal periods beginning after December 15, 2017, but early adoption is permitted. Adoption of this ASU will significantly impact the presentation and disclosures of the financial statements. YES Prep will adopt this ASU effective for the fiscal year ended June 30, 2019.

NOTE 2 – BEGINNING NET ASSETS

During 2016, YES Prep determined that its pledges receivable, bequests receivable, and beneficial interest in charitable trust, and the resulting unrestricted net assets were understated by \$6,753,842 at June 30, 2015. Unrestricted net assets as of July 1, 2015 were restated to properly reflect these assets.

NOTE 3 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents at June 30, 2016 consist of the following:

Demand deposits	\$ 11,652,211
TexPool and TexSTAR investment pools	<u>17,259,511</u>
Total cash and cash equivalents	<u>\$ 28,911,722</u>

TexPool and TexSTAR are Texas Local Government Investment Pools, which operate in a manner consistent with SEC Rule 2a-7 of the Investment Company Act of 1940 and fully comply with the Texas Public Funds Investment Act, Chapter 2256 of the Texas Government Code. These investment pools use amortized cost rather than market value to report net assets and to compute share prices. Accordingly, the fair value of the position in TexPool and TexSTAR is the same value as the number of shares owned.

Bank deposits exceed the federally insured limit per depositor per institution.

NOTE 4 – PLEDGES RECEIVABLE

Pledges receivable at June 30, 2016 consist of the following:

Pledges receivable	\$ 2,588,000
Allowance for uncollectible pledges	<u>(755,000)</u>
Pledges receivable, net	<u>\$ 1,833,000</u>

Pledges receivable at June 30, 2016 are expected to be collected as follows:

Due within one year	\$ 1,072,750
Due in one to five years	<u>1,515,250</u>
Total pledges receivable	<u>\$ 2,588,000</u>

Concentration – At June 30, 2016, 56% of pledges receivable were due from two donors. In 2016, three donors provided 35% of contribution revenue.

YES Prep received two conditional pledges in 2014 and 2015 totaling \$13,100,000 from two foundations with payments contingent upon opening new schools. At June 30, 2016, the amount outstanding on these two gifts totaled \$8,800,000. In 2015, YES Prep received a \$2,500,000 conditional pledge from the Charter School Growth Fund. The payments are contingent upon meeting certain milestones and conditions. At June 30, 2016, the amount outstanding on this gift totaled \$1,500,000.

NOTE 5 – NOTE RECEIVABLE

In 2012, YES Prep loaned \$10,422,800 to COCRF Investor XIV, LLC (COCRF Investor). The loan matures on November 1, 2042 and bears interest at 1.31%, which is paid quarterly. The loan is interest only for the first seven years, until October 2019. Simultaneous to YES Prep making the loan, Capital One Bank, NA (the Bank) invested \$3,577,200 in COCRF Investor, which in turn placed these combined funds as equity in the form of a Qualified Equity Investment under section 45D of the Internal Revenue Code of 1986, as amended, into COCRF SubCDE XIV, LLC (COCRF CDE) and New Markets Investment 71, LLC (NMI 71). The loan from YES Prep to COCRF Investor is secured by COCRF Investor's interests in COCRF CDE and NMI 71. COCRF CDE and NMI 71 made loans to Facilities in the form of New Markets Tax Credit Qualified Low-Income Community Investments under Section 45D of the Internal Revenue Code of 1986, as amended, for the construction of YES Prep Fifth Ward and YES Prep Northside. Interest earned on the note for the year ended June 30, 2016 was \$136,641.

Put and Call Options

The Bank holds a put option on its investment in COCRF Investor, whereby it may sell its ownership to YES Prep at a prearranged price (\$178,860) during the six-month period commencing October 11, 2019 (Put Option Period).

YES Prep holds a call option on the Bank's investment, whereby it may purchase the Bank's interest in COCRF Investor if the Put Option Period expires and the Bank does not exercise its put option. The call option may be exercised during the six months immediately following the expiration of the Put Option Period. If YES Prep exercises its call option, the Bank is obligated to sell its investment interest in COCRF Investor to YES Prep at the then determined market value of the Bank's interest in COCRF Investor.

NOTE 6 – PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2016 is comprised of the following:

Land	\$ 8,984,944
Buildings and improvements	108,412,796
Furniture and equipment	7,261,727
Construction in progress	<u>1,763,560</u>
Total property and equipment, at cost	126,423,027
Accumulated depreciation	<u>(25,880,716)</u>
Property and equipment, net	<u>\$ 100,542,311</u>

NOTE 7 – BONDS AND NOTES PAYABLE

In March 2010, YES Prep entered into a Master Trust Indenture (MTI) for the purpose of issuing bonds. Under the MTI, YES Prep has the ability to issue additional debt on a parity basis. The MTI is secured by a first lien on YES Prep's revenue, as well as on certain real property of YES Prep. YES Prep is required to maintain 1.2 times debt coverage at each quarter-end while MTI debt is still outstanding. With the exception of the New Markets Tax Credit and the Charter School Growth Fund loans, all bonds and notes held by YES Prep exist under, and are subject to, the MTI.

Bonds and notes payable at June 30, 2016 consist of the following:

Qualified Zone Academy Bond, Taxable Series 2010Z, issued by the City of Houston Higher Education Finance Corporation. The investor earns 5.73% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 2% supplemental interest semi-annually. The bond is due April 1, 2025. The proceeds are being used to rehabilitate or repair specified campus facilities and are secured by real estate.	\$ 16,000,000
Qualified Zone Academy Bond, Taxable Series 2015Z, issued by the City of Houston Higher Education Finance Corporation. The investor earns 4.87% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 1% supplemental interest semi-annually. The bond is due April 1, 2030. The proceeds are being used to rehabilitate or repair specified campus facilities and are secured by real estate.	15,000,000
Qualified Zone Academy Bond, Taxable Series 2011Z, issued by the City of Houston Higher Education Finance Corporation. The investor earns 5.18% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 1.5% supplemental interest semi-annually. The bond is due April 1, 2026. The proceeds are being used to rehabilitate or repair specified campus facilities and are secured by real estate.	8,751,600
Note payable to New Markets Investment 71, LLC, issued in October 2012. Interest at 1% is paid quarterly. Principal payments begin on October 9, 2019 and are paid quarterly through maturity at November 1, 2042. Proceeds were used to finance buildings at YES Prep Fifth Ward and YES Prep Northside. The note is secured by real estate.	8,665,000
Series 2013 loan agreement with a bank issued by Dickinson Education Finance Corporation for \$9,740,000. The loan bears interest at 3.25% and payments are due in semi-annual installments through April 1, 2028. The proceeds were used to retire existing debt and to provide funding for expansions at YES Prep Southwest and YES Prep Fifth Ward. The loan is secured by real estate.	8,375,920
Series 2015 loan agreement with a bank issued by Dickinson Education Finance Corporation for \$7,000,000. Interest rate at 2.93%. Paid in semi-annual installments through April 1, 2030. The proceeds were used to renovate the YES Prep North Forest campus and to construct YES Prep System Office. The loan is secured by real estate and revenue streams.	6,533,334
Qualified School Construction Bond, Taxable Series 2010Q, issued by the City of Houston Higher Education Finance Corporation. The investor earns 5.82% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 2% supplemental interest semi-annually. The bond is due April 1, 2025. The proceeds are being used to construct specified campus facilities and are secured by real estate.	6,100,000
Note payable to COCRF SubCDE XIV, LLC, issued in October 2012. Interest at 1% per annum is paid quarterly. Principal payments begin on December 23, 2019 and are paid quarterly through maturity at November 1, 2042. Proceeds were used to finance buildings at YES Prep Fifth Ward and YES Prep Northside. The note is secured by real estate.	5,000,000

Qualified Zone Academy Bond, Taxable Series 2012Z, issued by the City of Houston Higher Education Finance Corporation. The investor earns 4.49% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 1% supplemental interest semi-annually. The bond is due April 1, 2027. The proceeds are being used to rehabilitate or repair specified campus facilities and are secured by real estate.

3,400,000

Loan agreement for \$2,300,000 with Charter School Growth Fund dated April 2015. Interest is at 0%. Principal payments are due in annual installments from June 2015 to June 2020. The loan is unsecured.

2,250,000

Loan agreement for \$2,500,000 with Charter School Growth Fund amended December 2014. Interest at 1%. Principal payments are due in annual installments in June 2020 and June 2021. The loan is unsecured.

1,045,000

Loan agreement for \$1,000,000 with Charter School Growth Fund dated December 2014. Interest at 1%. Principal payments are due in annual installments in June 2021 and June 2022, with interest due in June 2022. The loan is unsecured.

1,000,000

Loan agreement with a bank for \$7,890,935 dated June 2012. Interest and principal due monthly through maturity on June 8, 2019. Proceeds were used to acquire land and construct buildings. The loan is secured by real estate.

810,511

Loan agreement for \$200,000 with Charter School Growth Fund dated July 2013. Interest at 1%. Loan matures on June 30, 2019, with interest due at that time. The loan is unsecured.

200,000

Total bonds and notes payable \$ 83,131,365

Interest expense totaled approximately \$1,341,000 in 2016.

Maturities of bonds and notes payable, including interest, at June 30, 2016 are as follows:

	<u>PRINCIPAL</u>	<u>INTEREST</u>	<u>TOTAL</u>
2017	\$ 2,190,756	\$ 1,387,114	\$ 3,577,870
2018	1,960,010	1,343,294	3,303,304
2019	1,806,774	1,304,644	3,111,418
2020	2,548,750	1,268,233	3,816,983
2021	2,662,273	1,227,146	3,889,419
Thereafter	<u>71,962,802</u>	<u>7,931,158</u>	<u>79,893,960</u>
Total	<u>\$ 83,131,365</u>	<u>\$ 14,461,589</u>	<u>\$ 97,592,954</u>

YES Prep entered into two repurchase agreements for the purpose of funding the repayment of the bonds upon maturity. YES Prep makes equal annual deposits into these accounts over the 15-year term of the underlying bonds, and earns interest at rates varying between 2.18% and 4.259%. The combination of the annual deposits and interest earned on the accounts will provide the full amounts due upon maturity for each of the bonds.

YES Prep's minimum cash commitment under the repurchase agreements is as follows:

2017	\$ 2,558,713
2018	2,558,713
2019	2,558,713
2020	2,558,713
2021	2,558,713
Thereafter	<u>15,260,515</u>
Total	<u>\$ 28,054,080</u>

NOTE 8 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets at June 30, 2016 are available for the following purposes:

State funds for future educational expenses	\$ 12,722,323
College scholarships for YES Prep graduates	2,363,201
Teaching Excellence Center	1,000,000
Redefining Possible growth campaign	583,000
Innovation Fund	250,000
YES Prep future operations	200,000
Teacher Squared	119,129
Leading Excellence	<u>100,000</u>
Total temporarily restricted net assets	<u>\$ 17,337,653</u>

NOTE 9 – GOVERNMENT GRANTS

YES Prep is the recipient of government grants from various federal, state and local agencies. Government grants at June 30, 2016 include the following:

State grants:	
Texas Education Agency Foundation School Program Act	\$ 82,060,154
Textbook and Kindergarten Materials	834,487
School Lunch Matching	<u>22,465</u>
Total state grants	<u>82,917,106</u>
Federal grants:	
U. S. Department of Education	7,022,849
U. S. Department of Agriculture	<u>3,560,603</u>
Total federal grants	<u>10,583,452</u>
Total government grants	<u>\$ 93,500,558</u>

The grants from government funding sources require fulfillment of certain conditions as set forth in the grant contracts and are subject to review and audit by the awarding agencies. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds as a result of non-compliance by YES Prep with the terms of the contracts. Management believes such disallowances, if any, would not be material to YES Prep's financial position or changes in net assets.

NOTE 10 – COMMITMENTS

Lease commitments – YES Prep leases administrative offices and certain equipment under noncancellable operating leases. Future minimum lease payments are due as follows:

2017	\$ 849,287
2018	581,102
2019	555,797
2020	<u>46,316</u>
Total	<u>\$ 2,032,502</u>

Rental expense was approximately \$938,000 in 2016.

Construction commitments – In 2015, YES Prep entered into several contracts totaling approximately \$15.7 million for construction projects at certain schools and a home office. As of June 30, 2016, outstanding commitments totaled approximately \$1.4 million.

NOTE 11 – MULTIEMPLOYER PENSION PLAN

YES Prep's full-time employees participate in the Teacher Retirement System of Texas (TRS), a public employee retirement system. TRS is a cost-sharing, multiemployer, defined benefit pension plan. All risks and costs are not shared by YES Prep, but are the liability of the State of Texas. For 2016, plan members contribute 7.2% of their annual covered salary, YES Prep contributes 6.8% for new members the first 90 days of employment, and the State of Texas contributes 6.8%. Additionally, YES Prep makes a 1.5% non-OASDI payment on all TRS eligible employees. YES Prep's contributions do not represent more than 5% of the pension plan's total contributions. YES Prep contributed \$1,326,568 to the plan during fiscal year 2016, equal to the required contribution for the year.

The risks of participating in a multiemployer, defined benefit plan are different from single-employer plans because (a) amounts contributed to a multiemployer plan by one employer may be used to provide benefits to employees of other participating employers and (b) if an employer stops contributing to TRS, unfunded obligations of TRS may be required to be borne by the remaining employers. There is no withdrawal penalty for leaving TRS.

Total TRS plan assets as of August 31, 2015 were \$149.8 billion. Accumulated benefit obligations as of August 31, 2015 were \$163.9 billion. The plan was 78.43% funded at August 31, 2015.

NOTE 12 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through November 10, 2016, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.

YES Prep Public Schools, Inc.

Charter #101845

Supplemental Statement of Financial Position as of June 30, 2016

ASSETS

Current assets:

Cash and cash equivalents \$ 28,747,676

Receivables:

Government agencies 15,030,313

Bequests 1,000,000

Pledges 884,000

Other 971,200

Prepaid expenses and other assets 1,980,496

Total current assets 48,613,685

Pledges receivable, net 949,000

Beneficial interest in charitable trust 2,236,762

Note receivable 10,422,800

Capitalized bond issuance costs 1,684,054

Bond proceeds held in trust 153,821

Bond sinking funds 11,369,121

Property and equipment, net 100,501,138

TOTAL ASSETS \$ 175,930,381

LIABILITIES AND NET ASSETS

Current liabilities:

Accounts payable and other accrued expenses \$ 3,096,278

Accrued payroll expenses 7,234,783

Construction payable 1,108,133

Accrued interest 749,193

Due from Partnerships 29,402

Deferred revenue 1,000

Current portion of bonds and notes payable 2,190,756

Total current liabilities 14,409,545

Bonds and notes payable 80,940,609

Total liabilities 95,350,154

Minority interest in YES Prep Holdings, Inc. 12,815

Net assets:

Unrestricted 63,229,759

Temporarily restricted 17,337,653

Total net assets 80,567,412

TOTAL LIABILITIES AND NET ASSETS \$ 175,930,381

YES Prep Public Schools, Inc.

Charter #101845

Supplemental Statement of Activities for the year ended June 30, 2016

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Local program revenue:			
5740 Other revenue from local sources	\$ 4,589,901	\$ 2,825,432	\$ 7,415,333
5750 Co-curriculum/enterprising	<u>3,053,179</u>	<u> </u>	<u>3,053,179</u>
Total local support	<u>7,643,080</u>	<u>2,825,432</u>	<u>10,468,512</u>
State program revenue:			
5810 Foundation School Program Act Revenue		82,060,154	82,060,154
5820 State program revenue distributed by Texas Education Agency		<u>856,952</u>	<u>856,952</u>
Total state program revenues		<u>82,917,106</u>	<u>82,917,106</u>
Federal program revenue:			
5920 Federal revenue distributed by the State of Texas Education Agency		9,540,437	9,540,437
5940 Federal revenue distributed directly from the Federal government		<u>1,043,015</u>	<u>1,043,015</u>
Total federal program revenues		<u>10,583,452</u>	<u>10,583,452</u>
Total revenue	7,643,080	96,325,990	103,969,070
Net assets released from restrictions:			
Program expenditures	91,496,113	(91,496,113)	
Capital expenditures	3,206,185	(3,206,185)	
Expiration of time restrictions	<u>100,000</u>	<u>(100,000)</u>	<u> </u>
Total	<u>102,445,378</u>	<u>1,523,692</u>	<u>103,969,070</u>
EXPENSES:			
11 Instruction	42,925,280		42,925,280
12 Instructional resources and media services	131,173		131,173
13 Curriculum development and instructional staff development	4,566,989		4,566,989
21 Instructional leadership	2,432,960		2,432,960
23 School leadership	6,916,825		6,916,825
31 Guidance counseling and evaluation services	2,819,203		2,819,203
32 Social work services	1,620,834		1,620,834
33 Health services	314,970		314,970

(continued)

YES Prep Public Schools, Inc.

Charter #101845

Supplemental Statement of Activities for the year ended June 30, 2016

(continued)

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
34 Student transportation	5,185,883		5,185,883
35 Food services	3,568,574		3,568,574
36 Co-curricular and extracurricular activities	3,248,993		3,248,993
41 General administration	7,159,835		7,159,835
51 Plant maintenance and operations	11,349,502		11,349,502
52 Security and monitoring services	22,601		22,601
53 Data processing services	3,521,396		3,521,396
71 Debt service	1,534,704		1,534,704
81 Fundraising	<u>1,620,460</u>		<u>1,620,460</u>
Total expenses	<u>98,940,182</u>		<u>98,940,182</u>
CHANGES IN NET ASSETS	3,505,196	1,523,692	5,028,888
Net assets, beginning of year	<u>59,724,563</u>	<u>15,813,961</u>	<u>75,538,524</u>
Net assets, end of year	<u>\$ 63,229,759</u>	<u>\$ 17,337,653</u>	<u>\$ 80,567,412</u>

Note: Expenses include special event direct donor benefit costs of \$140,691 that are reported as reductions from special events revenue on the Statement of Activities.

YES Prep Public Schools, Inc.

Charter #101845

Supplemental Statement of Cash Flows for the year ended June 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES:

Changes in net assets	\$ 5,028,888
Adjustments to reconcile changes in net assets to net cash provided by operating activities:	
Contributions restricted for expansion of facilities	(2,000,000)
Loss on valuation of pledges	755,000
Depreciation	4,412,196
Amortization of bond issuance costs	122,395
Forgiveness of debt	(200,000)
Changes in operating assets and liabilities:	
Receivables	(324,424)
Prepaid expenses and other assets	(1,613,591)
Beneficial interest in charitable trust	(82,587)
Accounts payable and accrued expenses	1,976,006
Accrued interest	82,914
Deferred revenue	<u>(125,439)</u>
Net cash provided by operating activities	<u>8,031,358</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchases of property and equipment	<u>(723,523)</u>
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CASH FLOWS FROM FINANCING ACTIVITIES:

Change in bond sinking funds	(2,919,506)
Capitalized bond issuance costs	(156,281)
Proceeds from bonds and notes payable	7,500,000
Principal repayments on bonds and notes payable	(4,971,389)
Proceeds from contributions restricted for expansion of facilities	<u>3,161,667</u>
Net cash provided by financing activities	<u>2,614,491</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS	9,922,326
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Cash and cash equivalents, beginning of year	<u>18,825,350</u>
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Cash and cash equivalents, end of year	<u>\$ 28,747,676</u>
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YES Prep Public Schools, Inc.

Charter #101845

Schedule of Expenses for the year ended June 30, 2016

6100	Payroll costs	\$ 64,468,225
6200	Professional and contracted services	19,082,028
6300	Supplies and materials	4,944,520
6400	Other operating costs	8,936,405
6500	Interest expense	<u>1,509,004</u>
Total		<u>\$ 98,940,182</u>

Note: Expenses include special event direct donor benefit costs of \$140,691 that are reported as reductions from special events revenue on the Statement of Activities.

YES Prep Public Schools, Inc.

Charter #101845

Schedule of Capital Assets as of June 30, 2016

<u>YES PREP PUBLIC SCHOOLS, INC.</u>		<u>OWNERSHIP INTEREST</u>			<u>TOTAL</u>
		<u>LOCAL</u>	<u>STATE</u>	<u>FEDERAL</u>	
1510	Land and improvements	\$ 7,423,159	\$ 1,561,785		\$ 8,984,944
1520	Buildings and improvements	105,482,719	4,422,088	\$ 91,525	109,996,332
1539	Furniture and equipment	4,768,012	1,644,385	782,421	7,194,818
1551	Leasehold improvements	48,860	27,996	25,875	102,731
1569	Library books and media		66,909		66,909
Total		<u>\$ 117,722,750</u>	<u>\$ 7,723,163</u>	<u>\$ 899,821</u>	<u>\$ 126,345,734</u>

<u>PARTNERSHIP SCHOOLS</u>		<u>OWNERSHIP INTEREST</u>			<u>TOTAL</u>
		<u>LOCAL</u>	<u>STATE</u>	<u>FEDERAL</u>	
1510	Land and improvements				
1520	Buildings and improvements	\$ 30,595			\$ 30,595
1539	Furniture and equipment				
1551	Leasehold improvements	46,698			46,698
1569	Library books and media				
Total		<u>\$ 77,293</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 77,293</u>

<u>TOTAL CAPITAL ASSETS</u>		<u>OWNERSHIP INTEREST</u>			<u>TOTAL</u>
		<u>LOCAL</u>	<u>STATE</u>	<u>FEDERAL</u>	
1510	Land and improvements	\$ 7,423,159	\$ 1,561,785		\$ 8,984,944
1520	Buildings and improvements	105,513,314	4,422,088	\$ 91,525	110,026,927
1539	Furniture and equipment	4,768,012	1,644,385	782,421	7,194,818
1551	Leasehold improvements	95,558	27,996	25,875	149,429
1569	Library books and media		66,909		66,909
Total		<u>\$ 117,800,043</u>	<u>\$ 7,723,163</u>	<u>\$ 899,821</u>	<u>\$ 126,423,027</u>

YES Prep Public Schools, Inc.

Charter #101845

Budgetary Comparison Schedule for the year ended June 30, 2016

		BUDGETED AMOUNTS		ACTUAL	VARIANCE
		ORIGINAL	FINAL	AMOUNTS	FROM FINAL BUDGET
REVENUE:					
Local program revenue:					
5740	Other revenue from local sources	\$ 6,790,367	\$ 6,790,367	\$ 7,415,333	\$ 624,966 (3)
5750	Co-curriculum/enterprising	2,434,894	2,434,894	3,053,179	618,285 (4)
State program revenue:					
5810	Foundation School Program Act Revenue	82,856,796	82,856,796	82,060,154	(796,642)
5820	State program revenue distributed by Texas Education Agency	586,654	586,654	856,952	270,298 (2)
Federal program revenue:					
5920	Federal revenue distributed by the State of Texas Education Agency	9,016,903	9,016,903	9,540,437	523,534
5940	Federal revenue distributed directly from the Federal government	<u>1,775,022</u>	<u>1,775,022</u>	<u>1,043,015</u>	<u>(732,007) (1)</u>
Total revenue		<u>103,460,636</u>	<u>103,460,636</u>	<u>103,969,070</u>	<u>508,434</u>
EXPENSES:					
11	Instruction	42,258,965	42,908,545	42,925,280	16,735
12	Instructional resources and media services	136,987	136,987	131,173	(5,814)
13	Curriculum development and instructional staff development	3,780,380	4,780,380	4,566,989	(213,391)
21	Instructional leadership	3,529,099	2,367,099	2,432,960	65,861

(continued)

YES Prep Public Schools, Inc.

Charter #101845

Budgetary Comparison Schedule for the year ended June 30, 2016

(continued)

		BUDGETED AMOUNTS		ACTUAL	VARIANCE
		ORIGINAL	FINAL	AMOUNTS	FROM FINAL BUDGET
23	School leadership	8,009,073	7,334,493	6,916,825	(417,668)
31	Guidance counseling and evaluation services	2,199,546	2,669,546	2,819,203	149,657
32	Social work services	1,828,026	1,677,026	1,620,834	(56,192)
33	Health services	289,078	324,078	314,970	(9,108)
34	Student transportation	5,704,740	5,404,740	5,185,883	(218,857)
35	Food services	3,897,636	3,497,636	3,568,574	70,938
36	Co-curricular and extracurricular activities	2,381,080	2,731,080	3,248,993	517,913 (5)
41	General administration	8,556,483	8,256,483	7,159,835	(1,096,648) (6)
51	Plant maintenance and operations	9,884,453	9,884,453	11,349,502	1,465,049 (7)
52	Security and monitoring services		23,000	22,601	(399)
53	Data processing services	2,647,360	2,647,360	3,521,396	874,036 (8)
71	Debt service	1,111,582	1,676,582	1,534,704	(141,878)
81	Fundraising	1,081,291	976,291	1,620,460	644,169 (9)
Total expenses		<u>97,295,779</u>	<u>97,295,779</u>	<u>98,940,182</u>	<u>1,644,403</u>
CHANGES IN NET ASSETS		6,164,857	6,164,857	5,028,888	(1,135,969)
Net assets, beginning of year		<u>75,538,524</u>	<u>75,538,524</u>	<u>75,538,524</u>	<u>0</u>
Net assets, end of year		<u>\$ 81,703,381</u>	<u>\$ 81,703,381</u>	<u>\$ 80,567,412</u>	<u>\$ (1,135,969)</u>

Note: Expenses include special event direct donor benefit costs of \$140,691 that are reported as reductions from special events revenue on the Statement of Activities.

(continued)

YES Prep Public Schools, Inc.

Charter #101845

Budget Variance Explanations for the year ended June 30, 2016

- (1) YES Prep did not fully expend budgeted funds from the ACE, CSP, and TTT grants, therefore, the related revenues were not received.
 - (2) YES Prep decided to utilize IMAT rollover funds in order to purchase student devices for a technology initiative. Initially, YES Prep only budgeted for the portion of IMAT funds they planned to utilize for textbook purchases. The purchase of student technology utilized around \$300,000 of IMAT funds rolled over from the previous year. This purchase was not budgeted.
 - (3) YES Prep did not budget for any E-Rate revenue or related expenses pending funding approval. YES Prep also underestimated interest revenue related to sinking fund arrangements.
 - (4) YES Prep underestimated sales revenue for campus uniforms, tickets and book sales revenue, which totaled \$408,000 of additional revenues. YES Prep included Food Service collections from students in Federal Revenues distributed by the TEA incorrectly. The actual collections of \$124,000 are appropriately recorded here.
 - (5) YES Prep includes expenses related to the sale of items on campus in this function and those expenses exceeded budget by \$400,000, but had associated revenue noted in item (2).
 - (6) YES Prep had significant savings at the home office/general administration level due to budgeted positions that were not filled throughout the year.
 - (7) YES Prep underestimated contracted facility maintenance and repair costs on campus as well as depreciation expense for new construction.
 - (8) YES Prep did not budget for E-Rate revenue or expense, pending funding approval. Once the program budget was approved, E-Rate expenditures were made.
 - (9) YES Prep changed one of its signature fundraising events, The College Bash, from an evening event to a morning one, A Community Breakfast. This resulted in significant cost savings. The savings were offset by recording an allowance for uncollectible contributions in the amount of \$755,000.
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YES Prep Public Schools, Inc.Schedule of Expenditures of Federal Awards for the year ended June 30, 2016FEDERAL GRANTOR

<u>Pass-through Grantor</u> <u>Program Title & Period</u>	<u>CFDA</u> <u>Number</u>	<u>Grant</u> <u>Number</u>	<u>Award</u> <u>Amount</u>	<u>Federal</u> <u>Expenditures</u>
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U. S. DEPARTMENT OF AGRICULTURE

Passed through Texas Education Agency:

#1 National School Breakfast Program				
10/01/14 – 09/30/15	10.553	71401501	N/A	\$ 71,226
10/01/15 – 09/30/16	10.553	71401601	N/A	302,455
#2 National School Lunch Program				
10/01/14 – 09/30/15	10.555	71301501	N/A	620,720
10/01/15 – 09/30/16	10.555	71301601	N/A	<u>2,566,202</u>

Total U. S. Department of Agriculture				<u>3,560,603</u>
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U. S. DEPARTMENT OF EDUCATION

Direct Federal Funding:

#3 Charter Schools Program				
10/01/14 – 09/30/15	84.282M	U282M100019-14	\$471,453	1,500
#4 Charter Schools Program				
10/01/14 – 09/30/19	84.282M	U282M140017-15	\$2,671,164	744,026
#5 Title II, Part C, Transition to Teaching				
10/01/15 – 09/30/16	84.350A	U350A110020-15	\$449,758	297,490

Passed through Texas Education Agency:

#6 Title I, Part A, Grants to Local Education Agencies				
09/04/15 – 09/30/16	84.010A	16-6101011-01845	\$2,689,444	2,650,206
#7 IDEA-B Formula, Special Education Grants to States				
08/27/15 – 09/30/16	84.027A	16-6600011-0184566	\$1,125,684	1,125,223
#8 Title IV, Part B, 21 st Century Community Learning Centers				
08/01/15 – 07/31/16	84.287C	16-6950197110033	\$1,678,791	1,463,122
#9 Title III, Part A, English Language Acquisition State Grants				
09/04/15 – 09/30/16	84.365A	16-671001-101845	\$84,971	76,236
#10 Title II, Part A, Supporting Effective Instruction State Grants				
09/04/15 – 09/30/16	84.367A	16-694501-101845	\$487,773	487,775

Passed through Harris County Department of Education:

#11 Title IV, Part B, 21 st Century Community Learning Centers				
08/01/15 – 07/31/16	84.287C	16-6950167110020	\$150,798	<u>177,271</u>

Total U. S. Department of Education				<u>7,022,849</u>
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TOTAL FEDERAL EXPENDITURES				<u>\$10,583,452</u>
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See accompanying notes to schedule of expenditures of federal awards.

YES Prep Public Schools, Inc.

Notes to Schedule of Expenditures of Federal Awards for the year ended June 30, 2016

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – The schedule of expenditures of federal awards is prepared on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U. S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Federal expenditures include only allowable costs funded by federal awards. Allowable costs are subject to the cost principles of the Uniform Guidance, the standards of OMB Circular A-122, *Cost Principles for Non-Profit Organizations* and include costs that are recognized in YES Prep's financial statements in conformity with generally accepted accounting principles. YES Prep has elected not to use the 10% de minimus rate for indirect costs.

Because the schedule presents only a selected portion of the operations of YES Prep, they are not intended to and do not present the financial position, changes in net assets, or cash flows of YES Prep.

NOTE 2 – SUMMARY BY CFDA NUMBER

Federal funds expended by YES Prep, by CFDA number or CFDA cluster, are summarized as follows:

<u>CFDA Number(s)</u>	<u>Name of Program or Cluster</u>	<u>Amount</u>
10.553, 10.555	Child Nutrition Cluster	\$ 3,560,603
84.010A	Title I, Part A, Improving Basic Programs	2,650,206
84.027A	IDEA-B Formula	1,125,223
84.282M	Charter Schools Program	745,526
84.287C	21 st Century Community Learning Centers	1,640,393
84.350A	Transition to Teaching	297,490
84.365A	Title III, Part A, English Language Acquisition State Grants	76,236
84.367A	Title II, Part A, Improving Teacher Quality State Grants	<u>487,775</u>
Total		<u>\$ 10,583,452</u>

**Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

To the Board of Directors of
YES Prep Public Schools, Inc.:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of YES Prep Public Schools, Inc. (YES Prep), which comprise the statement of financial position as of June 30, 2016 and the related statements of activities and of cash flows for the year then ended, and the related notes to the financial statements and have issued our report thereon dated November 10, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered YES Prep's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of YES Prep's internal control. Accordingly, we do not express an opinion on the effectiveness of YES Prep's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and questioned costs as finding #2016-001, that we consider to be a material weakness.

YES Prep's response to the finding identified in our audit is described in the accompanying Corrective Action Plan. YES Prep's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether YES Prep's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Blazek & Vetterling

November 10, 2016

**Independent Auditors' Report on Compliance for Each Major Federal
Program and Report on Internal Control Over Compliance
Required by the Uniform Guidance**

To the Board of Directors of
YES Prep Public Schools, Inc.:

Report on Compliance for Each Major Federal Program

We have audited YES Prep Public Schools, Inc.'s (YES Prep) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of YES Prep's major federal programs for the year ended June 30, 2016. YES Prep's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of federal statutes, regulations, and the terms and conditions of its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of YES Prep's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U. S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about YES Prep's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of YES Prep's compliance.

Opinion on Each Major Federal Program

In our opinion, YES Prep complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2016.

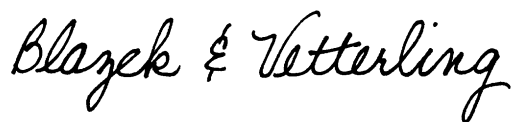
Report on Internal Control Over Compliance

Management of YES Prep is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered YES Prep's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of YES Prep's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



November 10, 2016

YES Prep Public Schools, Inc.

Schedule of Findings and Questioned Costs for the year ended June 30, 2016

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: ☒ unmodified ☐ qualified ☐ adverse ☐ disclaimer

Internal control over financial reporting:

- Material weakness(es) identified? ☒ yes ☐ no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? ☐ yes ☒ none reported

Noncompliance material to the financial statements noted? ☐ yes ☒ no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ☐ yes ☒ no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? ☐ yes ☒ none reported

Type of auditors' report issued on compliance for major programs: ☒ unmodified ☐ qualified ☐ adverse ☐ disclaimer

Any audit findings disclosed that are required to be reported in accordance with 2 CFR §200.516(a)? ☐ yes ☒ no

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Program or Cluster</u>
84.027A	IDEA-B Formula, Special Education Grants to States
84.282M	Charter Schools Program
84.350A	Title II, Part C, Transition to Teaching

Dollar threshold used to distinguish between Type A and Type B programs: \$750,000

Auditee qualified as a low-risk auditee? ☒ yes ☐ no

Section II – Financial Statement Findings

Finding #2016-001 – Material Weakness

Criteria: The management of YES Prep is responsible for establishing a system of internal control over financial reporting.

Condition and context: As a result of the audit, it was determined that approximately \$7 million of pledges receivable, bequests receivable, and interest in a charitable trust were not recorded at June 30, 2015. This amount represents over 10% of unadjusted net assets at that date. In addition, approximately \$1.2 million of payments on the pledges receivable were incorrectly recorded during 2016 as revenue. The amount represents approximately 20% of unadjusted contribution revenue for the year ended June 30, 2016.

Cause: YES Prep recorded its contributions and estate gifts on the cash basis instead of on the accrual basis and did not properly apply generally accepted accounting principles (GAAP) in recording these gifts.

Effect: Failure to adequately establish and maintain a system of internal control over the financial reporting of contributions adversely affects YES Prep's ability to prepare financial statements in accordance with GAAP. Audit adjustments were required to restate beginning net assets to comply with GAAP and to report contributions recorded for the year ended June 30, 2016 in accordance with GAAP.

Recommendation: Implement procedures to report contributions in accordance with GAAP.

Views of responsible officials and planned corrective actions: Management agrees with the finding. See the Corrective Action Plan.

Section III – Federal Award Findings and Questioned Costs

There were no findings for federal awards required to be reported in accordance with 2 CFR §200.516(a).

CORRECTIVE ACTION PLAN

November 10, 2016

U. S. DEPARTMENT OF EDUCATION

YES Prep respectfully submits the following corrective action plan for the year ended June 30, 2016. The audit was performed by: Blazek & Vetterling, 2900 Wesleyan, Suite 200, Houston, Texas, 77027.

The finding from the June 30, 2016 schedule of findings and questioned costs is discussed below.

FINDINGS – Financial Statement Findings

Finding #2016-001 – Material Weakness

Recommendation: Implement procedures to report contributions in accordance with GAAP.

Views of responsible officials and planned corrective actions: Effective immediately, the Advancement team will begin providing the Accounting Department by the last day of the month, all notifications of pledges, contributions, and estate gifts, which were received during the month. Such notifications will be recorded in the Advancement team's "salesforce.com" system when received and in the YES Prep accounting system in accordance with GAAP.

Responsible officer: Ann Ziker, Vice President of Advancement and Millicent Chancellor, Chief Financial Officer

Estimated completion date: Immediately

If the U. S. DEPARTMENT OF EDUCATION has questions regarding this plan, please call Millicent Chancellor at (713) 967-9179.

Sincerely,



Millicent Chancellor
Chief Financial Officer